

Message Text

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ACTION EB-04

INFO OCT-01 ADP-00 NSC-04 NSCE-00 TRSE-00 FRB-03 INR-01

CIEP-01 SS-04 RSC-01 RSR-01 /020 W

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R 081708 Z MAY 73

FM AMEMBASSY PARIS

TO SECSTATE WASHDC 9897

C O N F I D E N T I A L SECTION 1 OF 2 PARIS 12575

LIMDIS GREENBACK

E. O. 11652: GDS

TAGS: EFIN, IMF

SUBJECT: MEETING OF TECHNICAL GROUP OF C-20 ON DISEQUILIBRATING
CAPITAL FLOWS, MAY 2-4 (PART 1 OF 2 PARTS)

PASS TREASURY FOR DEPUTY UNDER SECRETARY BENNETT AND FEDERAL
RESERVE FOR BRYANT

GENERAL REVIEW

MOST COUNTRIES, EXCEPT NETHERLANDS, EMPHASIZED IMPORTANT
CRISIS ROLE OF LEADS AND LAGS. IN DISCUSSING THEIR CONTROLS,
SEVERAL COUNTRIES, INCLUDING FRANCE, JAPAN, AND NETHERLANDS, SAID
THAT BANKS WERE VERY RELUCTANT TO REFUSE TO ACCEPT DEPOSITS FROM
NON- RESIDENTS. ONLY BELGIUM SEEMED PREPARED TO REQUIRE BANKS TO
REFUSE DEPOSITS. INTERNATIONAL COMPETITIVE PRESSURES WERE CITED
AS A GENERAL INHIBITING FACTOR ON NATIONAL CONTROLS OVER BANKING
SYSTEMS, AND THIS LED SEVERAL DELEGATIONS TO ARGUE THE NEED FOR AN
INTERNATIONAL APPROACH, THE IMPLICATION BEING THAT AMERICAN BANKS
WERE PART OF THIS INTERNATIONAL COMPETITIVE SITUATION. THE
BRAZILIAN REPRESENTATIVE OBJECTED TO GERMAN AND OTHER EUROPEAN
CRITICISM OF THE EURO- DOLLAR MARKET AND ARGUED THAT FINANCING OF
LEADS AND LAGS CAN BE AND IS FINANCED BY NATIONAL MARKETS AND IS
NOT DEPENDENT ON THE EURO- MARKET. THE CANADIAN REPRESENTATIVE SUG-
GESTED THAT LEADS AND LAGS CAN AFFECT CAPITAL TRANSACTIONS AS WELL
AS CURRENT TRANSACTIONS, SINCE BORROWING COUNTRIES MAY DRAW DOWN
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RECEIPTS IN SOME CURRENCIES MORE RAPIDLY THAN IN OTHERS, DEPEND-
ING ON THEIR VIEW OF PROSPECTIVE EXCHANGE RATE CHANGES.

THE CHAIRMAN CONCLUDED THAT THE INITIAL REVIEW REVEALED NO

VERY NEW TRUTHS. PRIVATE CAPITAL FLOWS PRESENTED THE MAIN PROBLEM. LEADS AND LAGS WERE THE MOST DIFFICULT TRANSACTIONS TO CONTROL. SHIFTS IN LEADS AND LAGS COULD BE VERY LARGE IN A SHORT TIME. WE KNOW LESS ABOUT THE ACTUAL OPERATIONS AND WHO CARRIES THEM OUT THAN WE KNOW ABOUT THE COMPONENTS OF FLOWS. WE CAN MEASURE BANKING TRANSACTIONS, WHICH FINANCE A SUBSTANTIAL PART OF THE DISEQUILIBRATING FLOWS. NON- RESIDENTS' BALANCES PRESENT SPECIAL PROBLEMS PARTICULARLY FOR SOME COUNTRIES.

FUTURE OF DISEQUILIBRATING MOVEMENTS

IMF REPRESENTATIVE AND NETHERLANDS REPRESENTATIVE EXPECTED FLOWS TO CONTINUE IN FUTURE MONETARY SYSTEMS BECAUSE OF PUBLIC' S INCREASED AWARENESS OF POTENTIAL EXCHANGE MOVEMENTS AND LARGE MASSES OF LIQUID ASSETS IN ALL NATIONAL CURRENCIES RELATIVE TO GNP. FRENCH REPRESENTATIVE SAID CURRENT ACCOUNTS CAN BE BALANCED ONLY OVER TIME AND THIS MEANT THERE WOULD STILL BE IMPORTANT CAPITAL MOVEMENTS. HE THOUGHT FLOATING RATES AND CONTROLS SHOULD REDUCE THE MAGNITUDE OF THE PROBLEM AND LEAVE LEADS AND LAGS AS THE RESIDUAL CONCERN. CANADIAN REPRESENTATIVE ARGUED AGAINST THE TERM " DISEQUILIBRATING" AS PREJUDICIAL, SINCE MOST CAPITAL FLOWS HAD IN FACT PUSHED THE WORLD TOWARD A BETTER EXCHANGE RATE PATTERN. U. S. REPRESENTATIVE ENDORSED THIS COMMENT. HOWEVER, MARRIS (OECD) CITED THE IMPORTANCE TO THE MARKET OF " REVALUATION- PRONE" CURRENCIES AND THOS THAT WERE NOT IN THIS CATEGORY. THE GUILDER WAS IN THE FORMER GROUP AND THE BELGIAN FRANC IN THE LATTER, WITH NO LOGICAL BASIS FOR THIS DISTINCTION IN THEIR RESPECTIVE PAYMENTS POSITIONS. THE FRENCH REPRESENTATIVE CITED INTERNAL POLITICAL CONDITIONS AS A MAJOR FACTOR. HOWEVER, CANADA, ITALY AND BRAZIL CONTINUED TO ARGUE THAT A BETTER ADJUSTMENT PROCESS WOULD REDUCE THE SIZE OF FLOWS IN THE FUTURE. THE BRITISH REPRESENTATIVE SAID WE HAD EXPERIENCED CAPITAL FLOWS THAT WERE JUSTIFIED BY THE NEED TO ADJUST EXCHANGE RATES, BUT WE HAD ALSO EXPERIENCED SOME FLOWS WITHOUT SUCH JUSTIFICATION.

THE CHAIRMAN' S PERSONAL VIEW WAS THAT ALL COUNTRIES WOULD BE VEXED BY FUTURE DISEQUILIBRATING FLOWS. HE DECIDED TO KEEP THE CONFIDENTIAL

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TERM " DISEQUILIBRATING," WHILE RECOGNIZING THAT SOME MOVEMENTS WERE HELPFUL. HE CONSIDERED THAT THE MOST RECENT MOVEMENTS HAD NOT REPEAT NOT BEEN RELATED TO UNDERLYING EXCHANGE MALADJUSTMENTS. SOME CURRENCIES HAD TENDED TO BECOME TYPE- CAST AS REVALUATION- PRONE CURRENCIES. A MIDDLE POSITION WAS THAT MOBILE FLOWS MIGHT BE LESS PROMINENT BUT WOULD PROBABLY NOT DISAPPEAR WITH IMPROVEMENT IN THE ADJUSTMENT PROCESS.

EURO- MARKETS AND DIVERSIFICATION OF RESERVES

FLEMING (IMF) CALCULATED THAT IN 2 YEARS 1971-2, INDUSTRIAL COUNTRIES HAD ACCUMULATED SDR 30 BILLION IN RESERVES IN CLAIMS ON THE U. S. AND THE U. K. NON- INDUSTRIAL COUNTRIES HAD BUILT UP RESERVES

BY SDR 18 BILLION, 15 BILLION OF WHICH WAS IN FORMS OTHER THAN DIRECT CLAIMS ON U. S. AND U. K. ALLOWING FOR ABOUT SDR 8 BILLION IN 1970 AND SOME ROUGHT ADJUSTMENT, HE ESTIMATED THAT COUNTRIES HELD SDR 21 BILLION OUTSIDE OF CLAIMS ON U. S. AND STERLING CLAIMS ON U. K. AT THE END OF 1972. U. K. REPRESENTATIVE NOTED THAT NON- INDUSTRIAL COUNTRIES HAD 81 PERCENT OF THEIR RESERVES IN TRADITIONAL FORMS IN 1964 AND ONLY 44 PERCENT IN THOSE FORMS AT END OF 1971.

MARRIS (OECD) ESTIMATED COMPOSITION OF NON- G-10 RESERVES AT END OF 1972 IN DOLLAR EQUIVALENT AS: TOTAL \$57 BILLION, GOLD AND SDRS \$12 BILLION, PERHAPS \$12 BILLION IN DIRECT DOLLAR CLAIMS, \$8 BILLION IN STERLING, MAINLY WITH DOLLAR GUARANTEE, AND THE REST IN EURO- DOLLARS AND CURRENCIES OTHER THAN DOLLARS AND STERLING.

DEALTRY (BIS) ESTIMATED RESERVES HELD IN EURO- CURRENCY MARKETS

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R 081708 Z MAY 73
FM AMEMBASSY PARIS
TO SECSTATE WASHDC 9898

C O N F I D E N T I A L SECTION 2 OF 2 PARIS 12575

LIMDIS GREENBACK

HAD RISEN \$15 BILLION TO \$20 BILLION IN 1970-72. HIS GUESS WAS ABOUT THREE QUARTERS HELD IN DOLLARS IN SEPTEMBER 1972.

CHAIRMAN ASKED THE INTERNATIONAL AGENCIES TO AGREE ON A SINGLE SET OF FIGURES. HE THOUGHT OFFICIAL DIVERSIFICATION WAS NOT SO CONCENTRATED ON CRISIS PERIODS AS PRIVATE FLOWS. G-10 COUNTRIES HAD AGREED IN MID-1970 NOT TO INCREASE RESERVES HELD IN EURO- DOLLARS OR IN CURRENCIES OTHER THAN DOLLARS.

RIEKE (GERMANY) THOUGH ABOUT \$3 BILLION OF OFFICIAL FUNDS COULD BE TRACED IN BUDESBANK AND GERMAN PRIVATE BANKS AS OF END APRIL 1973. POSSIBLY LONG- TERM DM BONDS AND EURO- DM HOLDINGS AND OTHER NON- TRACEABLE HOLDINGS MIGHT BE 1-1/2 TO 3 BILLION DOLLARS. JAPANESE REPRESENTATIVE REPORTED A SMALL AMOUNT OF OFFICIAL HOLDINGS OF YEN IN FREE YEN ACCOUNTS OR SECURITIES. POLICY WAS TO DISCOURAGE SUCH HOLDINGS. BRAZILIAN REPRESENTATIVE AND OTHER LATIN AMERICAN REPRESENTATIVES EXPLAINED ADVANTAGES OF HOLDING

EURO- DOLLARS FOR BETTER INTEREST RATES AND TO FACILITATE BORROWINGS IN EURO- MARKET. DIZ (ARGENTINA) SAID BURDEN OF NON- DOLLAR DEBT TO EUROPEANS HAD INCREASED WITH DOLLAR DEVALUATION, AND DIVERSIFICATION TO THEIR CURRENCIES COULD AVOID EXCHANGE RISK. CHOI (MALAYSIA) ARGUED THAT DIVERSIFICATION TO AVOID EXCHANGE RISK WOULD NOT BE VOLATILE BUT WOULD STAY. EURO- DOLLAR RATES WERE HIGHER. QUITE A PROPORTION OF RESERVES WAS INVESTED AT LONG- TERM. FRENCH AFRICAN REPRESENTATIVE SAID THERE WAS NO DIVERSIFICATION NOW UNDER AGREEMENTS WITH FRANCE BUT MIGHT BE SOME IN FUTURE. AUSTRALIANS
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SAID THEY WERE PRETTY CLEAN BUT MIGHT BE LED TO DIVERSIFY IF THERE WERE TO BE INVOLUNTARY CONSOLIDATION AND A RESERVE ASSET SETTLEMENT SYSTEM. BRITISH REPRESENTATIVE SAID THE MIDDLE EASTERN COUNTRIES WERE SEARCHING FOR LONG- TERM RENUMERATIVE ASSETS, INCLUDING SECURITIES AND REAL ESTATE. FRENCH REPRESENTATIVE SAID NEW AGREEMENTS WITH FRENCH AFRICA ALLOWED MORE DIVERSIFICATION IN FUTURE. AT END 1972, SDR 600 MILLION WAS HELD IN FRENCH FRANCS BY BIS AND NATIONAL GOVERNMENTS, EXCLUDING THEIR HOLDINGS IN COMMERCIAL BANKS. CHOI (MALAYSIA) SAID ASIAN DOLLAR MARKET HAD NOW REACHED \$ 3 BILLION. DID NOT KNOW WHETHER OTHERS HAD MADE OFFICIAL DEPOSITS THERE -- MALAYSIA HAD NOT.

NATIONAL CONTROL SYSTEMS

JAPANESE WERE QUESTIONED AT LENGTH ON THEIR SYSTEM. JAPANESE REPRESENTATIVE SAID AN INFLOW OF FUNDS NOW REQUIRES APPROVAL, WHILE OUTFLOW IS FREE, REVERSING EARLIER CONTROLS. BANKS MUST KEEP SPOT FOREIGN ASSETS ABOUT EQUAL TO OR ABOVE SPOT FOREIGN LIABILITIES. BANKS CAN BORROW DOLLARS EQUALS TO THEIR TRADE BILL HOLDINGS. SYSTEM PREVENTS INFLOWS THROUGH NON- TRADE BILLS. IN AUGUST 1971, JAPAN RECEIVED MORE THAN \$4 BILLION IN LEADS AND LAGS WITH MONTHLY EXPORTS OF \$3 BILLION. AUTHORITIES NOT SATISFIED WITH CONTROLS AND SUBSEQUENTLY FORBADE EXPORTERS TO TAKE PROCEEDS IN ADVANCE OF DELIVERIES. NO RESTRICTIONS WERE IMPOSED ON TERMS FOR FINANCING IMPORTS. BANKS ACCEPT FREE YEN DEPOSITS ON DEMAND, BUT DO NOT ENCOURAGE TIME DEPOSITS AND PAY SMALL INTEREST ON THEM. AN ATTEMPT TO IMPOSE A CEILING ON FREE YEN DEPOSITS WAS ABANDONED BECAUSE IT WAS SO UNPOPULAR WITH BANKS. NET PURCHASES OF JAPANESE SECURITIES BY FOREIGNERS ARE NOT PERMITTED, BUT THERE APPEARED TO BE LEEWAY FOR FURTHER ACQUISITIONS, SO THAT SEPARATE SECURITY EXCHANGE RATE HAD NOT REPEAT NOT APPEARED IN MARKET. IN FEBRUARY- MARCH 1973 JAPANESE BANKS BORROWED \$2 BILLION FROM U. S. BANKS. THE BARDEPOT AND NEGATIVE INTEREST AS PRACTICED IN EUROPE WOULD BE TOO BRUTAL FOR JAPAN. BANKS MUST BUY FOREIGN CURRENCIES WHEN FREE YAN DEPOSITS RISE IN ORDER TO KEEP SPOT POSITION BALANCED OR POSITIVE. AT PRESENT FREE YEN DEPOSITS ARE ABOUT \$1 BILLION IN JAPANESE BANKS AT HOME AND ABROAD.

CHAIRMAN SUGGESTED JAPANESE MEASURES WERE EFFECTIVE BECAUSE OF GENERAL PATTERN OF RESPECT FOR AUTHORITY AND GEOGRAPHICAL REMOTENESS. IN RESPONSE TO QUESTION, JAPANESE SAID JAPANESE BANKS

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CAN SELL DOLLARS FORWARD TO COVER A NET SPOT POSITION. FOREIGNERS NOW HOLD ABOUT \$200 MILLION IN JAPANESE SECURITIES TO COVER YEN REQUIREMENTS FOR SHIP PURCHASES, AND THIS PERMITS PURCHASES OF SECURITIES WITHOUT A SECURITY MARKET PREMIUM EXCHANGE RATE. AMOUNT OF TRADE INVOICED IN YEN IS ONLY 1 PERCENT OR LESS. JAPANESE SAID AS A MATTER OF POLICY WOULD WELCOME INVOICING IN YEN BUT DO NOT REPEAT NOT REQUIRE IT. ISOBE (B/ J) SAID IS VERY HARD TO DRAW LINE BETWEEN SPECULATIVE AND NON- SPECULATIVE TRANSACTIONS IN ADMINISTERING CONTROLS AND FRICTION BETWEEN BANKS AND CUSTOMERS IN UNAVOIDABLE. THIS IS A PROBLEM FOR DUAL MARKET ARRANGMENTS.

LITTLER (U. K.) POINTED TO THE DIFFICULTIES OF A FINANCIAL CENTER THAT HAS AN ENORMOUS VARIETY OF CHANNELS WITH OTHER AREAS. CONTROLS HAVE TO PERMIT CONTINUANCE OF ESTABLISHED BUSINESS RELATIONS. U. K. PLACES LIMITS ON SWITCHING INTO AND OUT OF STERLING, IN TERMS OF TOTAL SPOT PLUS FORWARD POSITION OF EACH BANK IN ALL FOREIGN CURRENCIES TAKEN TOGETHER. THERE IS A SECOND LIMIT ON THE NET SPOT POSITION IN ALL FOREIGN CURRENCIES TAKEN TOGETHER. BANKS MAY DO WHAT THEY WISH WITH THE FOREIGN CURRENCY HELD ON THEIR OWN ACCOUNT. OTHER U. K. RESIDENTS CAN ACQUIRE FOREIGN CURRENCIES ONLY UNDER REGULAR EXCHANGE CONTROL RULES.

CHAIRMAN AND FRENCH REPRESENTATIVE AGREED FRANCE HAS FULL PANOPY OF ALL TYPES OF EXCHANGE RESTRICTIONS, THOUGH NOT ALL USED SIMULTANEOUSLY. BASIC DISTINCTION IS BETWEEN RESIDENTS AND NON-RESIDENTS. DUAL MARKET DOES REQUIRE FULL CONTROL OVER CURRENT TRANSACTIONS. CHAIRMAN COMMENTED THAT DUAL MARKET WOULD BE VERY DIFFICULT FOR ANY COUNTRY NOT USED TO SUCH CONTROLS. BELGIAN REPRESENTATIVE SAID FRENCH SYSTEM WAS MORE COMPLEX THAN BELGIAN, BECAUSE UNDER BELGIAN SYSTEM NORMALLY NO REPEAT NO AUTHORIZATIONS WERE NEEDED TO CARRY OUT ANY TYPE OF NON- CURRENT TRANSACTIONS IN THE FINANCIAL MARKET, EXCEPT FOR TIGHTENED REGULATIONS AT TIME OF CRISIS. GENERALLY AUTHORITIES DID NOT INTERVENE IN FINANCIAL MARKETS IN BELGIUM AND FRANCE, BUT COULD DO SO. FRENCH BELIEVED THEY COULD LIVE THROUGH STORM WITH FULL ADMINISTRATIVE CONTROLS, ALTHOUGH THERE COULD BE SOME NON- RESIDENT SPECULATION.

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